2/17/87 RS650-2

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

NO. 6B
February 13, 1987

IN THIS ISSUE:

Congress Faces Uphill Battle In Developing Trade Compromise 1

Bentsen Introduces Omnibus Trade Legislation ... 2

CEA Report Stresses Link Between U.S. Trade And Budget Deficits 5

Japan's 1986 Balance Of Payments Sets New Records 8

Tax Reform Grabs Center Stage In Diet Debates 9

Update On Japan's Telecommunications Market ... 10

Notes: Rice Legislation 12

Congress Faces Uphill Battle In Developing Trade Compromise

Despite the emerging consensus in Congress and the White House that trade legislation is all but inevitable this year, areas of agreement are few and far between. The suggestions included in HR 3, S 490 and the preliminary administration proposal vary extensively in scope as well as procedure (see following table). Differences between the administration and the House are especially noticeable, and finding potential areas for compromise may be more difficult than the post-election "spirit of bipartisan cooperation" rhetoric implied.

While the White House has not unveiled a detailed version of its trade bill, it has given some indication of the measures it categorically opposes.

Relief from Imports in Strategically Vital Industries (Section 232 of the 1962 Trade Expansion Act) - The Senate proposal would require the president to respond within 90 days in Section 232 cases and to provide Congress with a written explanation of his decision. No provision concerning Section 232 is included in the House proposal.

U.S. Trade Policy - S 490 would create an executive-level National Trade Council; set up a National Trade Data Bank; and require all department heads to issue "trade impact statements" with regard to any major action. HR 3 also has extensive provisions to increase the dissemination of trade information and to improve U.S. competitiveness.

Agricultural Trade - The Senate bill would allow the Commodity Credit Corp. to give surplus commodities to cooperating organizations and to create a number of agricultural export promotion programs. HR 3 also includes several provisions to enhance agricultural trade.

Eileen Marie Doherty

CEA Report Stresses Link Between U.S. Trade And Budget Deficits

"The persistence of the Federal [budget] deficit late into the current expansion is one of the most important factors contributing to the growth of the trade deficit," according to the Council of Economic Advisers' 1987 Economic Report of the President. This analysis is a marked departure from the position taken earlier in the Reagan administration when the link between the two deficits was largely dismissed. Moreover, the report disputes the widespread notion that the competitiveness of U.S. manufacturing is a major problem, concluding that the country's strong productivity gains over the past five years were more than offset by the appreciation of the dollar from 1980 to 1985.

The study notes that the increase in imports of manufactured goods has spurred protectionism in this country, especially regarding Japan. But the rise in the U.S. trade deficit to $170 billion last year, it argues, reflects a deterioration with virtually all major U.S. trading partners rather than in a specific bilateral relationship. Although the deficit with Japan increased nearly $30 billion between 1982 and 1985, Japan's share of U.S. imports and exports changed only marginally (see Table 1).

Table 1: U.S. Trade in Manufactures, 1982 and 1985

Country/Area	Change in bilateral balance*	Share of U.S. imports 1982	Share of U.S. imports 1985	Share of U.S. exports 1982	Share of U.S. exports 1985
Canada	-$4.6	20.1%	18.8%	19.8%	26.2%
Japan	-29.8	25.1	26.6	6.6	7.6
Western Europe	-21.1	26.0	26.1	26.7	26.7
Latin America	-10.4	6.1	6.2	12.2	12.9
East Asian NICs**	-16.4	14.6	15.0	7.0	7.2

*In billions of dollar.
**Includes Hong Kong, Singapore, South Korea, and Taiwan.

Source: Council of Economic Advisers, Economic Report of the President, 1987.

The rise in the U.S. trade deficit to more than 4 percent of real gross national product in 1986, the study says, is a "macroeconomic phenomenon" that is a result of strong growth in the U.S. economy relative to other countries, the debt crisis and the appreciation of the dollar from 1980 to 1985. Weak economic recoveries abroad slowed U.S. exports while U.S. imports surged, helping to sustain the relatively weak economic recovery in other industrial nations but contributing to the plunge in the U.S. trade balance. The 3.1 percent average annual growth of real domestic demand in Japan from 1982 to 1985, for example, was well below this country's 5.6 percent rate (see Table 2). But the change in trade balances equalized the real GNP growth rates in the two countries.

Table 2: Economic Growth in Major Industrial Countries

(average annual percent change)

	1970 to 1980		1980 to 1985		1982 to 1985	
Country	Real domestic demand	Real GNP	Real domestic demand	Real GNP	Real domestic demand	Real GNP
United States	2.5%	2.8%	3.4%	2.4%	5.6%	4.2%
Canada*	4.9	4.6	2.1	2.5	4.2	4.2
Japan	4.2	4.7	2.8	3.9	3.1	4.3
France*	3.7	3.6	1.2	1.2	0.8	1.2
Germany	2.7	2.7	0.2	1.3	1.9	2.4
Italy*	2.9	3.1	0.4	0.9	1.5	1.7
United Kingdom*	1.7	1.9	1.9	1.9	3.1	3.1

*Based on real gross domestic product.

Source: Council of Economic Advisers, Economic Report of the President, 1987.

The report stresses that as the U.S. current account deficit declines, stronger internal growth in other industrial countries is necessary to maintain satisfactory growth in the world economy. This can be achieved by removing the structural distortions that impede growth. In the case of Japan, the report suggests removing restrictions that prevent the efficient use of scarce land and lifting controls on consumer credit that limit the demand for consumer durables.

The CEA points out that the deterioration in the U.S. international payments position is closely related to changes in national saving and investment. The private saving-investment balance -- the difference between private saving and private investment -- fell from 3.5 percent of GNP in 1982 to a negative 0.1 percent in 1986. This reflects the normal growth of consumption and investment over the course of the economic recovery. It has been accompanied, however, by an unprecedented deterioration in the U.S. fiscal position during an expansion. The general government budget deficit, equivalent to 3.4 percent of GNP in 1986, brought in large capital inflows and resulted in a

corresponding current account deficit. The study warns Congress that "a vote for more government spending is a vote against correcting our trade deficit."

The study downplays the importance of America's industrial "competitiveness" problem, which Congress and the administration have been promoting as a central theme of this year's economic policy debate. Last month, for example, President Reagan unveiled 43 proposals to improve the U.S. competitive position in the world. The CEA points out, however, that U.S. labor productivity in manufacturing has grown at an annual rate of 3.8 percent since 1981 compared to the postwar average of 2.6 percent. At the same time, real hourly compensation in manufacturing has been held to an average annual rate of 1 percent since the business cycle peak, only half the postwar average.

As a result of strong productivity growth and modest wage gains, unit labor costs in manufacturing have actually risen more slowly here than abroad (see Table 3). But the 5 percent gain in this country's international cost competitiveness (based on national currencies) was wiped out by the rise in the dollar in the first half of the decade, which boosted the ratio of U.S. unit labor costs to foreign unit labor costs by 39 percent. The gap, however, has been narrowed significantly by the appreciation of the dollar since 1985.

Table 3: U.S. and Foreign Unit Labor Costs, 1980-85

(1980=100)

		Other Industrial Countries*	
Year	United States	National currency basis	Dollar basis
1980	100.0	100.0	100.0
1981	107.3	108.2	96.9
1982	114.0	114.4	91.6
1983	111.1	115.4	88.5
1984	110.5	115.1	81.9
1985	111.2	116.3	80.3

*Trade-weighted average of Belgium, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Norway, Sweden and United Kingdom.

Source: Council of Economic Advisers, Economic Report of the President, 1987.

The CEA calls on all countries to avoid new protectionist measures and to reduce existing barriers. Protectionism is likely to increase in other countries as they face serious adjustment problems stemming from the decline in the U.S. trade deficit. It would be unfortunate, the report states, if the "United States were to suggest -- just as its trade position was beginning to improve -- that protectionist measures were an acceptable response to these adjustment pressures."

Randall S. Jones

Japan's 1986 Balance Of Payments Sets New Records

Japan's current account and trade surpluses jumped to record highs in 1986, propelled by an 18 percent rise in exports to $205.6 billion (see Table 1). At the same time, the all-time-high net long-term capital outflow indicated that Japan was actively recycling these funds abroad.

Table 1: Japan's Global Balance of Payments

(in millions of dollars, IMF value basis)

	1982	1983	1984	1985	1986*
Current Account	$6,850	$20,799	$35,003	$49,169	$85,966
Trade Balance	18,079	31,454	44,257	55,986	92,659
Exports (f.o.b.)	137,663	145,468	168,290	174,015	205,558
Imports (f.o.b.)	119,584	114,014	124,033	118,029	112,899
Services	-9,848	-9,106	-7,747	-5,165	-4,633
Transfers	-1,381	-1,549	-1,507	-1,652	-2,060
Long-Term Capital	-14,969	-17,700	-49,651	-64,542	-131,814
Basic Balance	-8,119	3,099	-14,648	-15,373	-45,848
Short-Term Capital	-1,579	23	-4,295	-936	-1,302
Errors and Omissions	4,727	2,055	3,743	3,991	2,383
Overall Balance	-4,971	5,177	-15,200	-12,318	-44,767

*Preliminary.

Source: The Bank of Japan

As expected, the appreciation of the yen began to influence trade flows in 1986. Based on Japan's customs clearance data, export volume fell 1.4 percent while import volume rose 13.3 percent, but these changes were more than offset by the realignment of exchange rates that boosted the trade surplus from $56 billion in 1985 to $92.7 billion last year.

Led by the increased trade surplus, the current account surplus rose to $86 billion. A fifth annual decline in the services deficit also contributed to the increase. This improvement resulted from a 37.4 percent rise in net investment income to $9.4 billion, reflecting Japan's status as the world's largest creditor nation.

There are signs that the J-curve effect may have peaked, at least for exports, in the July-September period last year, making a decline in the 1987 surplus likely. The Organization for Economic Cooperation and Development predicts that Japan's trade and current account surpluses will fall by about $4 billion each.

Japan's net long-term capital outflow more than doubled to $131.8 billion in 1986 (see Table 2). Net direct foreign investment increased substantially to a record $14.3 billion, as more firms moved production facilities abroad in order to remain competitive. Most of the increased outflow, though, was a result of big purchases of foreign securities, which rose to $101.6 billion, with bonds accounting for $95.1 billion. While a breakdown by region is

not yet available, it is likely that the U.S. share of net portfolio investment matched 1985's 70 percent.

Table 2: Net Long-Term Capital Flows

(in millions of dollars)

	1985			1986*		
	Outflows	Inflows	Net	Outflows	Inflows	Net
Direct Investment	-$6,452	$642	-$5,810	-$14,478	$224	-$14,254
Trade Credits	-2,817	29	-2,788	-2,040	-41	-2,081
Loans	-10,427	-75	-10,502	-9,153	-34	-9,187
Securities	-59,773	16,741	-43,032	-102,108	545	-101,563
Stocks	-995	-673	-1,668	-7,048	-15,758	-22,806
Bonds	-53,479	4,524	-48,955	-93,024	-2,109	-95,133
Yen-denominated Bonds Issued in Japan	-5,299	n.a.	-5,299	-2,036	n.a.	-2,036
External Bonds**	n.a.	12,890	12,890	n.a.	18,412	18,412
Other	-2,346	-64	-2,410	-4,583	-146	-4,729
Total	-81,815	17,273	-64,542	-132,362	548	-131,814

Note: A negative sign indicates a capital outflow.

*Preliminary.
**Bonds issued outside of Japan by Japanese institutions.

Source: The Bank of Japan

Randall S. Jones

Tax Reform Grabs Center Stage In Diet Debates

The current Diet session is off to a rocky start as opposition and majority party members alike direct a barrage at the Nakasone cabinet's proposal to offset proposed personal income tax cuts with a 5 percent sales tax. The intensity of the debate suggests that tax reform is within the government's grasp but will not be achieved easily.

The government's difficulties began almost as soon as the prime minister delivered his policy address January 26 (see JEI Report No. 5B, February 6, 1987). Opposition parties led a walkout from the Diet, halting proceedings for five working days until they secured token compromises from the government on the tax reform debate. The walkout -- a stale opposition tactic left over from countless sessions in the past -- betrayed the claims of minority party leaders that they would vigorously pursue new policy options. It is particularly disappointing in the case of Takako Doi, head of the Japan Socialist Party, whose designation as the first woman to lead a major political party in Japan is said